No. 16534

United States Court of Appeals
For the Ninth Circuit

TIME OIL COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ON PETITION TO REVIEW AND CORRECT A DECISION OF THE TAX COURT OF THE UNITED STATES TO ACCORD WITH THE MANDATE OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF PETITIONER

JONES, GREY, KEHOE, HOOPER & OLSEN
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BRIEF OF PETITIONER

OPINION BELOW

The decision of the Tax Court (R. 21) was entered April 7, 1959.

STATEMENT AS TO JURISDICTION

This is a petition to review and correct the above decision of the Tax Court of the United States to accord with the mandate of this Court, dated September 8, 1958, remanding the case to the Tax Court for further proceedings. The decision of the Tax Court was entered April 7, 1959, after respondent filed a recomputation pursuant to the mandate of this Court and petitioner filed a recomputation and objections to respondent's recomputation, and after oral argument of both petitioner and respondent at Washington, D.C., on April

1, 1959, the Tax Court's decision approved respondent's recomputation. Petitioner filed the Petition to Correct the Decision of the Tax Court to accord with the Mandate of the United States Court of Appeals for the Ninth Circuit on May 4, 1959, and served and filed a Notice of Filing Petition to Correct the Decision of the Tax Court on May 5, 1959. The jurisdiction of this Court is based on Section 7481 (3) (B) (iii) of the Internal Revenue Code as amended, petitioner's petition being filed within the thirty-day period provided therein.

NATURE OF CONTROVERSY AND ARGUMENT

Petitioner's recomputation for entry of decision pursuant to the mandate of the Court of Appeals for the Ninth Circuit would result in a deficiency for 1949 of $24,522.81, and a deficiency for 1950 of $1,233.22. Respondent's recomputation and the Tax Court's decision which followed respondent's recomputation resulted in a deficiency for 1949 of $32,588.60 and a deficiency for 1950 of $22,889.39.

The Court of Appeals' ultimate decision was:

> "After taking the view of the law hereinabove indicated, this Court must now come to the question of the year of deductibility of the employer's payments. The Third Circuit has taken the view that taxpayer on an accrual basis is entitled to deduct promissory notes as a contribution in the year issued. *Sachs and Slaymaker v. Commissioner,* 208 F.2d 313. This Court fully agrees with the case of *Anthony P. Miller, Inc.,* 3 Cir. 164 F. 2d 268 (on its facts) upon which the Court of Ap-

peals for the Third Circuit relies in *Sachs and Slaymaker.* Under Section 23(p)(1) E of the 1939 Code a taxpayer 'on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year.' The *Sachs-Slaymaker* decision is a reasonable, but not a required extension of the *Miller* case. The point is a close one. In such circumstances it seems unnecessary to set up a conflict between circuits. *Therefore, it is held that delivery of the notes to the trustee constituted payment by Time Oil Company as of the delivery date.* This would determine the year of deductibility.

"In the background of this case is the question of amounts allowable as deductions under permissible limits of the statute. It would appear that under the principles laid down *the allowable deductions can be readily calculated by the tax court for the years in which the note obligations were discharged.*" (Emphasis ours).

There were four note contributions involved in the proceeding.

The first note was in the amount of $30,466.86. While the note was dated January 10, 1948, and was issued presumably as a contribution for the year 1947, the record shows (Tr. 28) that it was not delivered to the trustees until May of 1948. The record further shows that the respondent denied petitioner a deduction for the $30,466.86 in the year 1947, and that petitioner signed a waiver of restrictions on assessment and

collection of the resulting deficiency in tax (Tr. 28 and 29).

The second note is in the amount of $66,342.82 and was issued February 28, 1949, presumably as a contribution for the year 1948. The record shows (Tr. 29) that the respondent disallowed this as a deduction for petitioner in 1948 and petitioner signed a waiver of restrictions on assessments and collection of the resulting deficiency in tax.

The third note is in the amount of $84,568.49 and was issued February 15, 1950.

The fourth note was in the amount of $25,067.96 and was issued April 17, 1950.

The only amounts in controversy in this petition to correct the decision of the Tax Court to accord with the mandate of the United States Court of Appeals are the $30,466.86 represented by the note dated January 10, 1948, and $42,347.54 of the $66,342.82 note issued February 28, 1949. The recomputation of the respondent and the Tax Court's decision would throw the deduction for the amounts of $30,466.86 and $42,347.54 into the year 1948, which is now a barred year, and this would deny petitioner any benefits from the deduction whatsoever despite the fact that respondent had previously denied petitioner any deduction for these amounts in the years 1947 and 1948 in the first place when taxpayer had so taken them.

One important consideration should be initially noted. This case was remanded at respondent's insist-

ence in footnote 12 of his brief to enable the Tax Court to determine the allowable deductions under the primary and secondary limitations of Section 23(p)(1)(C) of the Code and Regulations 111, Sec. 29.23 (p)-10 relating thereto. There is no disagreement between the parties hereto that the full amounts of deductions as now asserted by petitioner would be allowable under the primary and secondary limitations of the Statute and Regulations referred to (R. 15).

The position of the respondent and the Tax Court is premised on a construction of the Court of Appeals' ultimate decision to the effect that the note issued in May of 1948 in the amount of $30,466.86 has to be charged to that year since it was issued in that year more than sixty days after the close of the year 1947, and $42,347.54 of the $66,342.82 note issued February 28, 1949, has to be charged to that same 1948 year because the note was a contribution for the year 1948 and constituted payment on the last day of that year because it was issued within sixty days of the close of that year. The $42,347.54 is the maximum respondent can allocate to the year 1948 under the limitation of 15% of the aggregate compensation of eligible employees for that year.

It is the position of the petitioner that the Court of Appeals in this case authorized the deduction for the $66,342.82 in the year 1949 since the note was delivered in the year 1949.

The Court of Appeals was following the position of the Third Circuit in *Sachs and Slaymaker v. Com-*

missioner, 208 F.2d 313, in holding that "delivery of the notes to the trustee constituted payment by Time Oil Company as of the delivery date." Had the Court of Appeals intended to relate the payment back to the last day of 1948 under Section 23(p)(1)(E) providing that a taxpayer "on the accrual basis shall be deemed to have made payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year," it would have said so. It is petitioner's position that the Court of Appeals was aware of the fact that respondent had already denied petitioner a deduction for this amount in 1948 and that petitioner had filed a waiver and paid the resulting deficiency (Tr. 29).

In addition, the position of the Tax Court and the respondent on the $66,342.82 note issued in 1949 completely overlooks one important aspect of Section 23 (p)(1)(E) of the Code. While Section 23(p)(1)(E) provides that a taxpayer "on the accrual basis shall be deemed to have made payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year," the accrual has been deemed to be permissive rather than mandatory.

The American Law Institute "Basic Pension and Profit-Sharing Plans" (June, 1957), pages 16 and 17, point this out in stating:

> "Even though the employer is on the accrual basis of accounting, the general rule is that contributions under a qualified plan are deductible only

for the taxable year of the employer in which they are paid. However, since the largest proportion of employers are on the accrual basis, there is an exception to this general rule which is a tail that wags the dog. It is that an accrual basis employer may accrue a contribution as of the last day of the employer's taxable year and deduct the contribution, subject to the applicable limitations as to amount, if it is actually paid by the due date for filing the employer's income tax return for the taxable year. Before the 1954 Code, the accrued contribution had to be paid within sixty days after the end of the taxable year."

The Commissioner's own regulations established the permissive nature of the deduction. In Regulations 111, Section 29.23(p)-1, referring to Section 23(p)(1)(E) of the Code, the Commissioner states:

> "This latter provision is intended to permit a taxpayer on the accrual basis to deduct such accrued contribution or compensation provided payment is actually made within sixty days after the close of the year of accrual."

It would appear to petitioner that it would be astounding indeed if respondent could here deny this petitioner a permissive deduction in 1948 and then, after petitioner acquiesces in such denial, later force the deduction back to that year when any benefit is barred by the Statute of Limitations.

It is petitioner's position that the Court of Appeals authorized the deduction of even the $30,466.86 note in 1949 when paid, even though issued in 1948, when it concluded:

"It would appear that under the principles laid down, the allowable deductions can readily be calculated by the Tax Court for the years in which the note obligations were discharged."

The use of the word "discharged" would clearly indicate a deduction at the time of payment of the note if deduction had not been allowed at the time the note was issued.

Petitioner's contentions do not in any way distort income or advance principles incompatible with equity.

As shown by petitioner's recomputation (R. 15) the amounts of allowable deductions under the primary and secondary limitations of Sections 23(p)(1)(C) of the Code and Regulations 111, Section 29.23(p)-10 relating thereto are $103,124.62 and $131,131.50 for the years ending December 31, 1949, and December 31, 1950, respectively, while the actual amounts of the deduction here asserted by petitioner are $96,809.68 for 1949, and $109,636.45 for 1950.

From the standpoint of equity not only is it completely one-sided in favor of petitioner but respondent might well be precluded by estoppel or election in that he denied the deductions to petitioner in the first place, in the prior years, and he now insists on relating the deductions back to the prior years when the Statute of Limitations bars any benefit to petitioner.

The following cases demonstrate the application of estoppel or election in analogous situations and, while they are all instances where the doctrine has been successfully asserted against the taxpayer, the doctrine is

likewise available against the Government, even though, as pointed out by the Court of Appeals for the District of Columbia in *Vestal v. Commissioner,* 152 F. 2d 132; "the doctrine of election and estoppel must be applied with great caution to the Government and its officials. But in proper circumstances it does apply."

In the case of *F. R. Daugette v. Patterson,* 250 F. 2d 753 CA-5, cert. denied 356 U.S. 902, the court held that a taxpayer was estopped on a claim for refund after signing an 870-AD settlement agreement with the Government, even though it was not a final closing agreement, and then filing a claim for refund on the last day of the period open under the Statute of Limitations, the court holding estoppel applicable because the Government could not reinstate the deficiencies originally proposed because of the Statute of Limitations.

In the case of *Stern Bros. v. U.S.,* 8 F.Supp. 705, the taxpayer deducted thirteen months' rent in the year 1929 and eleven months' rent in the year 1930. After the Government had acquiesced in the deduction for the year 1929, and after the Statute of Limitations had run on that year, the taxpayer filed a claim for refund for the year 1930 alleging that it was entitled to a deduction for twelve months' rent in that year. The court held that the taxpayer was estopped in pressing its claim for refund for 1930 since the Government was barred by the Statute of Limitations from making proper adjustments for the year 1929.

In the cases of *Houbigant, Inc.,* 31 B.T.A. 954; aff'd

80 F.2d 1012; Cert. denied, 298 U.S. 699; and *Victoria Paper Mills Co.,* 32 B.T.A. 666; aff'd 83 F.2d 1022, the courts held that where over a period of years a taxpayer, keeping its books on the accrual basis, deducts and is allowed in its income tax returns for such years taxes or customs duties currently accrued and paid and in a later year it is determined that by reason of over-valuations, or the application of excessive rates under valid laws, the amounts theretofore paid were excessive and a portion thereof is refunded and where it further appears that the income tax returns for the years in respect of which the deductions were taken and allowed are not then open to adjustment, the amount refunded is to be treated as taxable income in the year in which the refund is made.

The case of *Elsie S. Eckstein,* 41 B.T.A. 746, went even further. There the taxpayer had accrued an excessive amount and after the Commissioner had acquiesced and the statute had run on the year of accrual the taxpayer adjusted the books of account in a later year. The court held that the over-accrual was taxable income in the later year. The court said "While in the instant case the petitioner did not actually pay the real property taxes for 1932 and secure a refund in the taxable year as in *Houbigant, Inc.* and *Victoria Paper Mills Co.* cited above, the actual payment of the taxes is of no moment. In those cases, as in the instant case, the books of account were kept and income reported by the accrual method and the right to the deduction claimed rested in each instance upon the actual accrual on the books of account of the amount of such

taxes then considered to be the amount properly accruable, and in each case the correct amount of such taxes was determined and the previous accrual was adjusted in the year before us. On authority of the cases cited, the respondent's treatment of the real property taxes for 1932 is sustained." The respondent's treatment was that the 1932 over-accrual of taxes constituted taxable income in 1934 to the extent of the reduction on the books to reflect the difference between the amount accrued and the amount ultimately paid. The court noted that the Commissioner had approved taxpayer's 1932 accrual and the Statute of Limitations had run on reopening that year.

CONCLUSION

It is petitioner's position that the Court of Appeals intended to give this trust the complete tax benefits it was entitled to as a qualified trust despite "the shortcomings of the errant taxpayer." It did not intend to give 60% relief through the construction advanced by the respondent and adopted by the Tax Court.

Respectfully submitted,

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